No. 600

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SAFE DEPOSIT AND TRUST COMPANY OF BALTIMORE, TRUSTEE UNDER WILLS OF R. J. REYNOLDS AND KATHARINE S. JOHNSTON, AND DEED OF KATHARINE S. JOHNSTON AND DECREE OF SUPERIOR COURT OF FORSYTH COUNTY N. C., ETC.

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ESTATES ADMINISTRATION, INC., ADMINISTRATOR ESTATE OF ZACHARY SMITH REYNOLDS, DECEASED.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI

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OPINIONS BELOW

As stated in the petition for certiorari the findings and opinion of the Board of Tax Appeals are contained in pages 1 to 46 of the printed record filed with the application for certiorari, and are reported in 42 B. T. A. 145. The case was reviewed by the entire Board

(R. p. 46), with no dissent. The affirming opinion o the Circuit Court of Appeals, likewise unanimous (R pp. 60-72), is reported in 121 F. (2nd) 307.

STATUTE AND REGULATIONS INVOLVED

As Zachary Smith Reynolds, the decedent, died on July 6, 1932 (R. p. 2), the statute applicable is the Revenue Act of 1926, Section 302, as correctly quoted on p. 3 of the petition for certiorari.

The Treasury Regulations in point are correctly quoted in the Appendix to the petition for certiorari and include articles 10, 11 and 24 of Treasury Regulations No. 80. These articles are however identical with the same numbered articles in Regulations No. 70, adopted after the passage of the law of 1926 and made effective January 1, 1927.

GROUNDS FOR CERTIORARI ALLEGED

The two grounds of error alleged are:

1. That an equitable life estate, plus a general power of testamentary appointment (or as elsewhere more vaguely stated by Petitioner, the "bundle of rights" which the decedent had at the time of his death, in the present case) should be held for purposes of estate tax under Section 302 (a) as equivalent to outright ownership by the decedent;

2. That under the decision in *Lyeth vs. Hoey*, 305 U. S. 188, some unascertained part of the 37½% allotted by the compromise in trust for the brother and sisters of the decedent should be considered as having been acquired by virtue of the attempted exercise of the power of appointment and therefore taxable under Section 302 (f) as property passing by exercise of a general testamentary power.

ARGUMENT

The case on the merits as to these two points is quite fully discussed and set forth in the opinion of the Circuit Court of Appeals (R. pp. 60-72; *Helvering vs. Safe Deposit Co., etc.*, 121 F. (2nd) 307). We do not propose to here discuss the case on the merits; beyond such extent as may be necessary to show that neither of these grounds presents any reason why this Court should take these questions up for review; the case presenting none of the situations which are set forth in Rule 38 (f) as indicating the character of reasons which will be considered on an application for certiorari.

I

The claim that an unexercised power of testamentary appointment plus an equitable interest (which terminated at the death of the decedent) in the property subject to the power, may be considered as substantially equivalent to outright ownership; and therefore as being part of a decedent's "gross estate" under Section 302 (a).

This contention was made in this form for the first time in Petitioner's brief on appeal to the C. C. A., four and a half years after the institution of the case by petition to the Board, and nearly nine years after the death of the decedent against whose estate the claim is asserted. The opinion of the Board of Tax Appeals (R. pp. 1-46) which discusses all of the claims advanced before that tribunal, shows that the present contention was not there asserted.

It is said in Petitioner's application (p. 10) that "the importance of the case derives more particularly from the similarity of the Reynolds trusts to innumerable other trusts, in which property of incalculable value has been placed, the taxability of which will be affected by

the decision here"; and again on p. 11 that "the decision will have a far reaching effect upon the revenues, since it will remove from the scope of the estate tax all property subject to trusts of this kind, when the power of appointment is not exercised". It is further frankly stated that "This is the first case in which the Government has sought to apply Section 302 (a) to a trust of the type herein involved." And that "there is, therefore, no direct conflict between the decision of the Court below and any decision of this Court or of any other Circuit Court of Appeals."[1]

This means that although the statute has remained in its present form at least since 1926, that the Department or Government has never asserted any similar claim, although the principle now invoked would apply to "*innumerable* other trusts, in which property of *incalculable* value has been placed."

And during this period of at least fifteen years for which the law has stood in its present form and, as stated by petitioner, innumerable similar trusts of incalculable value have been created, not only has no such claim been asserted by the Government in any reported case (including decisions of the Board of Tax Appeals); but so far as we are advised, no such claim against any estate has ever been asserted, or suggested in any ruling by the Department or even in any law magazine article. With all respect, therefore, the claim appears to be fantastic in its novelty; or what is commonly called an argument of desperation.

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[1]There is however, as clearly shown in the opinion of the Circuit Court of Appeals (R. p. 63, etc.; *Helvering v. Safe Deposit Co.*, 121 F. (2nd) 307-310, etc.), the most direct conflict and inconsistency of the claim now asserted, with former decisions of this Court and numerous decisions of Circuit Courts of Appeal.

None of the features mentioned in Rule 38 (f) as grounds which may induce this Court to review a case on certiorari, are present.[2] There is no conflict between the decision of the Circuit Court of Appeals in the present case, and the decisions of any other Court on the same matter; neither is any question of local law decided in a way which can be claimed to be in conflict with applicable local decisions. Neither can it be said to be true that the present case decides any question of Federal law which should be settled by this Court. Petitioner bases his claim on the proposition that the Court's decision on this point is "irreconcilable" (Pet., p. 14) with statements made in decisions of this Court, dealing with cases of taxability under other sections of the Revenue Laws; such as, for instance, the statute expressly making includible for estate tax purposes property which the decedent has settled in trust in his lifetime reserving

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[2]The amount of the Department's claim, swollen by eight years' interest (Pet., p. 9, note 3), is not one of the considerations indicated by the Rule as among those to be considered.

As stated by Mr. Chief Justice Taft in the opinion in *Magnum Import Co. vs. Coty*, 262 U. S. 159, 163:

> "The jurisdiction to bring up cases by certiorari from the Circuit Courts of Appeals was given for two purposes, first to secure uniformity of decision between those courts in the nine circuits, and second, to bring up cases involving questions of importance which it is in the public interest to have decided by this Court of last resort. The jurisdiction was not conferred upon this Court merely to give the defeated party in the Circuit Court of Appeals another hearing. Our experience shows that eighty per cent. of those who petition for certiorari do not appreciate these necessary limitations upon our issue of the writ."
>
> *Magnum Import Co. vs. Coty*, 262 U. S. 159, at p. 163.

Mr. Chief Justice Hughes in the address which he made to the annual meeting of the American Law Institute in May, 1934, referring to the great number of applications for certiorari that were made without substantial basis, said:

> "Applications are numerous in which there appears to

to himself substantial rights of possession or enjoyment; or dealing with the broad provisions of the income tax law, or with constitutional questions of what Congress or the States may constitutionally tax.

It is hardly necessary to call attention to the fact that the present case involves no trust created by the decedent. The trusts in question were created by his father and mother while he was still a young child.

The contention now made is moreover in direct conflict with the regulations of the Commissioner (Appendix to Petition for Certiorari, pp. 23-24) which expressly provide that "nothing should be included on account of a contingent remainder in case the contingency does not happen in the lifetime of the decedent and the interest consequently lapses at his death; nor should anything be included on account of an interest or an estate limited for the life of the decedent," and again that "only

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be no conflict of decision between the Circuit Courts of Appeals, or between Federal and State courts in cases where the latter should be controlling, and no real conflict with the decisions of the Supreme Court, and there is an utter absence of any good reason for asking our review. That review, we must emphasize, is in the interest of the law, not in the interest of particular parties. It is not the importance of the parties or the amount involved that is controlling, but the need of securing harmony of decision and the appropriate settlement of questions of general importance so that the system of federal justice may be appropriately administered. I commend to the Bar the provisions of Rule 38 of the Rules of the Supreme Court which deal comprehensively with this subject."

American Law Institute, Proceedings,
Vol. XI, p. 315.

In his address made before the same body in May, 1937, he reverted to the same subject and said that the purpose for which the writ was allowed was to carry out the intention of the Jurisdictional Act of 1925 in insuring the hearing of cases that are important in the interest of the law.

American Law Institute, Proceedings,
Vol. XIV, p. 34.

property passing under a general power should be included". What the Court is asked to do, contrary to all preceding authority and practice, is to establish the principle that the right to receive all or part of the income from a trust created by a third party, plus a general power of testamentary appointment,[3] or plus the

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[3]Petitioner argues in his application (note 7 on p. 16) that the decedent's inability under North Carolina law to exercise his powers of testamentary appointment until he attained twenty-one, was no different from the disability of a minor to will his own property, and was moreover an accidental restriction imposed by the law of his domicil, and therefore not inherent in his "basic power".

The appropriateness of the analogy sought to be drawn is not apparent. In this connection, however, it may be noted that Judge Clarkson in the opinion in the Cabarrus County case (as quoted in the opinion of the Board in the present case, R. pp. 25-27) said, after quoting the North Carolina statutes (do., p. 23), that it was to be inferred that R. J. Reynolds made his will with the North Carolina law in view, and that "no language gives the right of appointment under 21 years of age"; and further that "the wills of R. J. Reynolds and Katharine S. Johnston appear to indicate an intention that Zachary Smith Reynolds could only exercise the power of appointment after he became 21 years of age" (*Reynolds Guardianship*, 206 N. C. 276, at p. 290). And accordingly, in the Judgment in the Forsyth County case, it was found that "even if Zachary Smith Reynolds had the power to adopt a domicil of choice and execute a will in the State of New York which would affect his personal estate absolutely owned, such a will could not exercise the powers of appointment under the will of his father, R. J. Reynolds, and the will and deed of his mother, Katharine S. Johnston".

Rec. N. C. Proceedings, p. 671;
Reynolds vs. Reynolds, 208 N. C. 578 at p. 592.

If therefore he did not have such power before attaining 21, it would seem to be clear that at the time of his death he did not have a present power of testamentary appointment.

But as we have said, whether he did not have such a power, or had it but was "accidentally" restricted from exercising it, does not seem to be of any importance.

fact that had the decedent survived until he attained twenty-eight he might then have become entitled to receive the property absolutely under his father's will, or that any of the usual incidents of such trusts when coupled with a general power of testamentary appointment, require an investigation of whether such rights may not be substantially as beneficial as outright ownership. Any such suggestion of a *ratio decidendi* in such cases would leave the question involved in a legal fog, superadded by the Court to the plain provisions of the statute.

As pointed out in the opinion of the C. C. A. below (R. pp. 66-67; *Helvering vs. Safe Deposit Co.*, 121 F. (2nd) 307, 311-312, third paragraph of syllabus), the Federal estate tax originated as a tax on estates, as the word is used when we speak of the estate left by a deceased person; and all of the provisions including in the basis for taxation transactions which did not come strictly within this category, were added by express legislation, following decisions of this Court holding that the statute was not to be extended to include such cases. Whether or not Zachary Smith Reynolds' rights in the property subject to these trusts can be called generally an "interest", they were not rights which constituted any part of his "estate". At most it was, in the language of *May vs. Heiner*, 281 U. S. 238, 243, an interest possessed prior to death, which "was obliterated by that event", and did not survive as a part of his estate. Rights under limitations created by third parties, which are terminated by the beneficiary's death, manifestly constitute no part of the "estate" which he leaves for distribution after his death, and a greater injustice than

to tax his own estate for what is taken from him by his death can hardly be supposed.[4]

For purposes of argument we might accept the proposition that Zachary Smith Reynolds had a life estate plus a general power of testamentary appointment. In the great majority of cases where powers of testamentary appointment have been conferred they have been given to life beneficiaries (and this was true in substantially all of the cases cited in the opinion of the C. C. A. below involving the taxability of powers of appointment). He had, however, less than the equivalent of an equitable life estate, being entitled at most to have a very limited part of the income expended for his benefit prior to his attaining twenty-eight. The greater part of the income was to be accumulated and added to corpus, and made subject to the same limitations over.

In a recent case involving the rights of an elder brother of the present decedent as a beneficiary under his father's will, it was decided by the Circuit Court of Appeals for the Fourth Circuit, upon a thorough consideration of North Carolina decisions and upon the decisions of the North Carolina Supreme Court dealing with the pro-

[4] We do not intend to here suggest the constitutional question of the power to do so; but it may be noted as emphasizing the proposition that Federal Tax is normally imposed upon the "estate" of a decedent, that in the case in which it was decided by this Court that a State might constitutionally tax under an *inheritance* tax law, property passing under non exercise of a power of appointment, the decision in *Nichols vs. Coolidge*, 274 U. S. 531, that passage of title under trusts created prior to the passage of the Federal Estate Tax Law could not constitutionally be so taxed, was expressly distinguished from the case before the Court upon the ground that the State Tax was an inheritance tax imposed upon the donee's privilege of succession, and not, like the Federal Estate Tax, a tax upon the donor's estate.

Saltonstall vs. Saltonstall, 276 U. S. 260, 270-271.

visions of his father's will, that the testator's children took no vested estates until they should respectively attain twenty-eight; but a contingent remainder of principal to them in the event that they should survive until the age of twenty-eight.

Reynolds vs. Commissioner, 114 F. (2nd) 804.

While this case was reversed on the Federal question involved, this Court confined the review on certiorari to the Federal question and declined to take up any question of State law presented.

Helvering vs. Reynolds, 312 U. S. 672 (Grant of Certiorari);

Helvering vs. Reynolds, 313 U. S. ——; 61 Sup. Ct. Rep. 971.

The circumstance that Zachary Smith Reynolds would have become entitled to receive the principal under his father's will if he had survived until a future date was present in the case of *Morgan vs. Commissioner*. A full statement of the terms of the trusts involved in that case are set out in the opinion of the Circuit Court of Appeals below (*Morgan vs. Commissioner*, 103 F. (2nd) 636), but are sufficiently summarized in the opinion of this Court where it is said: "suffice it to say that under each" (of the trusts involved), "property remaining in the Trustee's hands for Elizabeth S. Morgan was given at her death to the appointee or appointees named in her will, with gifts over in case she failed to appoint".

Morgan vs. Commissioner, 309 U. S. 78, 79.

So, too, in *Helvering vs. Grinnell* the will had the feature relied upon by Petitioner in the present case (Pet. p. 5) that in default of the exercise of the power of appointment the trust property was to go to those per-

sons who might be considered as the natural objects of the donee's bounty. In the Grinnell case the decedent's share was limited in default of exercise of her power of appointment, to go to her children or issue, or alternatively to her next of kin.

Helvering vs. Grinnell, 294 U. S. 153, 154.

In conclusion therefore it is submitted, on this point, that no Federal question which has not already been abundantly settled by decisions of this Court as well as by numerous decisions of Circuit Courts of Appeals, and long-continued practice or usage, including express provisions in the Commissioner's Regulations, exists such as would induce this Court to take up so plain a question for review.

II

The claim that anything in the decision of this Court in Lyeth vs. Hoey, 305 U. S. 188, furnishes any ground for claiming that the amount of estate tax is affected by any subsequent compromise or agreement among the parties interested.

The second question which this Court is asked to take up has also none of the features indicated by Rule 38 (5) as considerations which may induce this Court to grant an application for certiorari. There is no conflict among the decisions of the Circuit Courts of Appeals on this question either before or subsequent to the decision of this Court in Lyeth vs. Hoey:

Robbins vs. Commissioner, 111 F. (2nd) 828, 831-2 (C. C. A. First Circuit, May 2, 1940);

Housman vs. Commissioner, 105 F. (2nd) 913 (C. C. A. Second Circuit, July 26, 1939); Certiorari denied, 309 U. S. 656;

White vs. Thomas, 116 F. (2nd) 147 (C. C. A. Fifth Circuit, December 5, 1940); Certiorari denied, 313 U. S. ——; 61 Sup. Ct. Rep. 1098.

These decisions were all subsequent to *Lyeth vs. Hoey;* and to the same effect is an earlier case:

Old Colony Trust Co. vs. Commissioner, 73 F. (2nd) 970, 971.

Apart from these decisions it is plain that the decision in *Lyeth vs. Hoey* furnishes no possible basis for a claim that a compromise of rights in an estate (in the present case arrived at many years after the basic date) should affect the incidence of estate tax, which attaches at the time of the decedent's death.

Lyeth vs. Hoey decided that property acquired in compromise of an alleged interest in an estate, which interest if realized would not have been taxable income, is exempt from taxation as income to the same extent as if the claim had been realized on in full.

Lyeth vs. Hoey, 305 U. S. 188.

From this it may be a fair inference that conversely amounts received in compromise of what would have been taxable income if received are taxable income. Income tax attaches as of the time of receipt of the income, but estate tax liability is determined as of the date of the death of the decedent, and subsequent transactions among the parties interested, or events, do not alter the incidence of the tax.

Moreover if the principle of *Lyeth vs. Hoey* were susceptible of any application to a compromise of interests in an estate, the rule would work both ways; and would apply equally to cut down the claims of the Government

in at least as many and probably more cases than it could operate to increase such claims.

The contention made with respect to this point by Petitioner (and substantially repeated in his present petition) was that the case should have been remanded to the Board for a finding of what the "proportionate contribution" of the claims asserted, to the compromise settlement was, and to take further evidence on that question (the State courts in their decisions approving the compromise having expressly declared and decided that the attempted exercise of the power of appointment was totally void).[5]

Any such conclusion as that so contended for would, like the first question sought to be raised, leave the situation in such cases in a legal fog, even if it were true that the New York will figured to any extent in the compromise. A more unsatisfactory method of determining

[5]It is suggested in a foot-note on page 21 of Petitioner's application, that unless the claim of the decedent's brother and sisters as appointees under the New York will was a substantial factor in the compromise, then they "made an incredibly good bargain", and that "their alternative contention was extremely tenuous". The suggestion is unimportant, but the contrary is obviously true. Any claim that the attempted appointment was valid had been practically disposed of by the North Carolina Supreme Court on the appeal in the Cabarrus County case (a bitterly contested case in which no concessions were made), decided before the compromise was suggested, in the language quoted from Judge Clarkson's opinion in that case by the Board in its opinion; R. p. 25 etc. "that the will of Zachary Smith Reynolds appears to be inoperative and void"; and in the petition submitting the suggested compromise (Record of North Carolina Proceedings, p. 147, etc.), in which the contentions of the several parties to the case are quite fully set forth, there is no mention of any claim under the New York will as constituting a valid appointment.

On the other hand the validity of the judgment barring the Cannon child and the validity of the Reno divorce, were the conditions which actually counted in the settlement. Whatever may be now suggested as to what would have been the

estate tax accruing at the death of the decedent, if there were any basis in the decisions for such a method, can hardly be imagined.

The compromise in the present case was, it should be noted, made effective by the two State Courts to which it was submitted. While suggested by the brother and sisters of the decedent, it was not a compromise which they had power to make, but one which only became effective by its adoption by the Court.

Moreover, as pointed out in the opinion of the C. C. A. below in the present case (R. p. 71), the thirty-seven and a half per cent which it is now claimed should be considered as in part allotted in satisfaction of a claim under the attempted appointment, was not allotted to the brother and sisters outright (as would have been the case if they had received it under an exercise of the power in the New York will); but was allotted to be added to the

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decision upon these two questions, they presented at the time most serious questions. The judgment was considered valid and proper not only by the prominent North Carolina lawyers who represented the parties at the time, but the Judge below in the Cabarrus County case thought it should not be attacked, and so decided or decreed (Rec. N. C. Proceedings, p. 58, &c.) and one of the Supreme Court Judges who sat on the appeal agreed with the Judge below in this respect.

What the situation before the Court and parties as to the question of the validity of the Reno divorce was, when the settlement was made, is quite apparent from the Record of that suit, which is included in full in the North Carolina Record (Rec. N. C. Proceedings, pp. 510-563); and from the account of how the divorce was obtained given by the lady chiefly concerned (do., p. 188-190), by her father (do., p. 611) and by her nurse (do., p. 651); all of which were before the Court when it entered the judgment effecting the settlement of these questions.

Reynolds vs. Reynolds, 208 N. C. 578, 592;
Cf. *Reynolds Guardianship*, 206 N. C. 276
(as quoted in opinion of Board, R. pp. 25-27);
Decree of Maryland Court, R. p. 52;
(quoted in opinion of C. C. A., R. p. 70).

shares already held in trust for them (with limitations over in the event of their death before attaining twenty-eight), or as the property would have passed in default of the exercise of the power of appointment under the terms of the father's will.'

The grounds for rejecting this contention are also more fully set forth in the opinion of the Circuit Court of Appeals below.

Helvering vs. Safe Deposit and Trust Company (R. pp. 70-72), 121 F. (2nd) 307, 314-315.

CONCLUSION

For the reasons above set forth it is respectfully submitted that the present case presents no substantial unsettled Federal question upon either of the two points sought to be raised, and that the Application for Certiorari should therefore be denied.

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September , 1941.